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C O N F I D E N T I A L SECTION 01 OF 05 TASHKENT 001595

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AMEMBASSY BELGRADE PASS TO AMEMBASSY PODGORICA
AMEMBASSY ATHENS PASS TO AMCONSUL THESSALONIKI

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SUBJECT: UZBEKISTAN: SCA DAS KROL'S MEETINGS ON ECONOMIC AND ENERGY ISSUES

REF: TASHKENT 1591

CLASSIFIED BY: Robert McCutcheon, Econ Officer, State, Pol/Econ Office; REASON: 1.4(B), (D)

¶1. (C) SUMMARY. On November 19 and 20, DAS for South and Central Asian Affairs George Krol had a series of meetings on economic, trade, and energy issues in Tashkent. Meetings at the Ministry of Foreign Economic Relations, Investment, and Trade and at the Uzbek Chamber of Commerce revolved primarily around the now familiar recitation of Uzbekistan's economic success in this year of global financial crisis and the need for greater foreign investment. Meetings at Uzbekneftegaz and Uzbekenergo, however, yielded new information on Uzbek plans in the oil and gas sectors, on opportunities for U.S. businesses in these plans, and on Uzbekistan's possible full or partial withdrawal from the Central Asia Power Grid on December 1. END SUMMARY.

UZBEKNEFTEGAZ: OIL AND GAS

¶2. (SBU) DAS Krol began his meeting with Uzbekneftegaz Chairman Ulugbek Nazarov by asking about plans to develop Uzbekistan's oil and gas sector, plans to diversify export markets, and possible roles for U.S. companies. Nazarov responded by describing Uzbekneftegaz as a national holding company with 120,000 employees that is responsible for the full spectrum of oil/gas operations ranging from prospecting, drilling, and producing to refining, transport, and export. He said prospecting is ongoing nearly everywhere from the oldest fields with proven reserves to new areas with good geological indicators. The goal, said Nazarov, is to increase gas reserves by 1.5 times by opening new fields and by drilling deeper in older areas.

¶3. (SBU) Nazarov continued that per capita gas consumption in Uzbekistan is 1.5-3 times greater than in the U.S., largely because most of the country's energy and power sectors are built on natural

gas. He said a presidential program to modernize the gas infrastructure will make gas usage more efficient. This will allow Uzbekistan to increase gas exports to a level approaching 30 bcm as compared with the 16 bcm exported in 2008.

14. (SBU) Nazarov said the first of two new gas pipelines from Turkmenistan to China will open in December with a capacity of 40 bcm. He continued that Uzbekistan believes in energy security and has an agreement to export up to 10 bcm to China when the second pipeline and associated infrastructure are completed. This will be in addition to its existing export markets in Europe (via Russia), Kyrgyzstan, Tajikistan, and southern Kazakhstan.

15. (SBU) Uzbekistan is actively seeking foreign investment in the oil and gas sector. Nazarov noted that Petronas, Sasol, China National Petroleum Company (CNPC), and several Korean companies are already active, and he added that Uzbekneftegaz is currently in talks with three U.S. companies. He said Uzbekistan needs new technology to increase output from older, underperforming sites, and he named Baker Hughes and Schlumberger as companies that can contribute in this area. "We're open to all countries," Nazarov concluded.

MFERIT: THE UZBEK ECONOMY IS COMING UP ROSES

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16. (SBU) DAS Krol met next with Minister Elyor Ganiev, recently promoted to Deputy Prime Minister, at the Ministry of Foreign Economic Relations, Investment, and Trade (MFERIT). Ganiev opened by citing oft-repeated statistics demonstrating the resilience of the Uzbek economy in this time of world financial crisis: 8 percent GDP growth and 10 percent growth in exports in the first nine months of 2009. Ganiev attributed much of Uzbekistan's success this year to the GOU's anti-crisis program, which along with other measures allocates 43 billion USD to projects of national importance such as power plant upgrades and improving the highway network. He added that Uzbekistan still needs to attract more foreign investment, saying at least 6-8 billion USD is needed annually to maintain 8 percent GDP growth, whereas there has been only 4.5 billion USD this year.

17. (SBU) Ganiev noted successful joint ventures in the automotive sector with foreign partners GM, Isuzu, and Mercedes, and he claimed thirty foreign companies have begun projects in the Navoi Free Industrial Economic Zone (FIEZ). He said there is still room in Navoi for U.S. companies, and he characterized his recent meeting with Honeywell CEO Dave Cote as very encouraging.

18. (SBU) On Afghanistan, Ganiev said Uzbekistan is ready to meet all standards required by the U.S. for local purchase, and he added that MFERIT is working with both the Embassy and CENTCOM on this issue. He said electricity exports have increased by nearly a factor of two this year, largely due to exports to Afghanistan. He noted that Uzbekistan is preparing to begin construction of the new ADB-funded Afghan rail extension from Hayraton to Mazar-i-Sharif.

19. (SBU) On the Central Asia Power Grid (CAPG), Ganiev said Uzbekistan is preparing to limit its participation due to accidents in neighboring countries. He characterized Tajik and Kyrgyz plans for large hydroelectric projects as "crazy," adding that they need to increase the efficiency of their internal grids, not criticize Uzbekistan.

¶10. (SBU) Commenting on the business climate in Uzbekistan, Ganiev said it is now possible to register a joint venture in a week. Taxes are dropping, particularly for small and medium enterprises (SMEs). He confirmed there have been some problems with customs and with conversion, but he characterized these all as temporary. As concerns reports that GM is having currency conversion problems, Ganiev said GM is a strategic partner and that there are no real problems.

¶11. (SBU) Responding to DAS Krol's question on Uzbekistan's withdrawal from the Moscow-led Eurasian Economic Community (EvrAzES), Ganiev quoted Uzbek President Karimov's statement that "economics creates politics." He continued that EvrAzES members are more interested in protecting their own industries than they are in crafting mutually-beneficial policies. He concluded that EvrAzES simply had not been effective.

¶12. (SBU) Ganiev talked about the increasingly important role of SMEs in Uzbekistan, saying they account for 48 percent of GDP this year. He said the GOU is doing all it can to create favorable conditions for SMEs, in particular low-cost financing. He

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cautioned, however, that cheap Chinese imports are still a factor and that contraband trade in Chinese goods via Kyrgyzstan can harm Uzbek SMEs.

¶13. (SBU) On agriculture, DAS Krol raised agricultural reforms and mechanization as ways possibly to address the issue of child labor in the cotton harvest. Ganiev reminded us that the acreage devoted to cotton has dropped by 50 percent since independence. He asserted there were no quotas on how much cotton a farmer must produce, just "serious recommendations" that must be acknowledged if a farmer wants government financing help. (COMMENT: These "serious recommendations" are, in effect, quotas in all but name. END COMMENT) Ganiev said the price for cotton in Uzbekistan is set in accordance with world prices. He said Uzbek farmers buy agricultural machinery produced both domestically and in Russia and China, but he added that tractors manufactured by the U.S. firm Case are just too expensive for Uzbek farmers. He repeated the GOU's claim, a claim we have heard many times before, that the issue of child labor in Uzbek agriculture is "fictitious" and reiterated that no children under 14 can be involved in agricultural work. He characterized the boycott of Uzbek cotton by WalMart and other chains as "stupid." Unlike the U.S., Ganiev said no genetically modified crops are grown in Uzbekistan. He described Uzbek cotton as genetically and ecologically clean.

¶14. (SBU) Finally, Ganiev said he saw the Shanghai Cooperation Organization (SCO) as having great economic potential. By removing trade barriers, SCO could develop the overland transit corridor from Beijing to Paris. He noted that China had opened a 10 billion USD credit line to SCO member countries at 0.75-2.0 percent interest rate. "We understand the nature of this loan," he said, "but the U.S. relegates Uzbekistan to the 6th category of risk, thereby making loans from the U.S. too expensive. At 8 percent, these loans carry a higher interest rate than the average 4 percent commercial loan." He continued that such limitations do not allow U.S. companies, GE being a good example, to participate in Uzbek projects directly.

SHAYKHOV RAMBLES ON

¶15. (SBU) In a long and rambling monologue, Alisher Shaykhov, Chairman of the Chamber of Commerce and Industry of Uzbekistan, said he liked to separate politics from business and that Uzbek businessmen want to make a profit when and where they can. He noted Uzbekistan's great potential for outsourcing but added that Uzbekistan should be viewed not just as a source of raw labor. He said that strong education in math and technical disciplines should make the country particularly attractive for information technology firms such as Microsoft and Cisco, but he deplored the lack of cooperation with U.S. companies. Shaykhov asked why it is so expensive to buy U.S. goods when China, in contrast, offers low interest loans to Uzbek firms that want to buy Chinese manufacturing equipment. Overall, Shaykhov said it was important to look at the development of the U.S.-Uzbekistan trade and business relationship over the long term, saying that he hoped he was building "a program for my grandson."

UZBEKENERGO: ELECTRICITY

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¶16. (SBU) DAS Krol's official meetings ended on a high note at Uzbekenergo, where he met with Deputy Chairman Bakhodir Abdurakhmanov. Krol began by asking directly about issues involving Tajikistan and whether Uzbekistan intends to withdraw from the Central Asia Power Grid (CAPG). Without answering directly, Adkurakhmanov said the Tajiks had not been cooperating with instructions issued by the Coordinating Dispatch Center (CDC) in Tashkent and had, rather, been improperly taking electricity from the grid above their allowed quota. Abdurakhmanov said Kazakhstan had demanded Uzbekistan take steps to prevent this but that rather than waiting, Kazakhstan had decided to pull out of the grid unilaterally, leaving Uzbekistan as the only country from which the Tajiks could still "steal" electricity. He continued that Tajikistan had "stolen" 58 million kWh in October alone. In August, Tajikistan did the opposite when it oversupplied the system with so much excess power that it caused an overload leading to a serious accident at Uzbekistan's Talimardjan Power Plant.

¶17. (SBU) Because of Kazakhstan's withdrawal and continuing problems with Tajikistan, Abdurakhmanov said that on December 1 Uzbekistan would disconnect line No. 57 that provides power via Guzar to that portion of Tajikistan that is served domestically by the Nurek hydroelectric plant. As of that date Uzbekistan will also cease operating its domestic grid in parallel with the Tajik system. Uzbekistan will, however, continue to provide electrical power to Khujand and northern Tajikistan and will seek to establish bilateral power relationships with both Kyrgyzstan and Tajikistan.

¶18. (SBU) Abdurakhmanov described in detail plans to renovate Uzbekistan's domestic electrical infrastructure, citing 38 projects costing 3.5 billion USD in accordance with a presidential program lasting through 2014. He said Uzbekenergo had just met with GE's representative regarding the turbines that GE is to provide for renovation of the Tashkent Power Plant, but he lamented that GE was participating in this project not directly but through a consortium of relatively unknown Eastern European firms. (COMMENT: Ganiev had made a similar comment. This is good news. GE had been in touch with us several times over the summer concerning fears that it and the entire consortium was being discarded in favor of Siemens. END COMMENT.) Abdurakhmanov described plans to upgrade other gas-fired power plants and said the door is open to participation by GE and other U.S. firms.

¶19. (SBU) In addition to providing improved electrical service in Uzbekistan, Abdurakhmanov told us the infrastructure upgrades will greatly improve efficiency and will, thereby, make more natural gas available for export. Uzbekistan plans to increase coal-fired power generation to 10 percent, build three relatively small hydroelectric plants, and upgrade existing hydroelectric facilities, all of which will make the country less dependent on gas.

COMMENT

¶20. (C) DAS Krol was originally scheduled to meet not with Abdurakhmanov but with Uzbekenergo Chairman Teshaboev and DPM Shoismatov. We were informed this meeting would not be possible because both Teshaboev and Shoismatov had been sent on an inspection tour of the country in preparation for the winter energy

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and heating season. We suspect, however, that the reason these two high level officials were on travel was more specific: to inspect the new 500 kW transmission line linking the Guzar and Surkhan substations. This line, which is scheduled to become operational on December 1, avoids Tajik territory and is the new element in Uzbekistan's domestic grid that will make it possible to disconnect line No. 57 to Tajikistan without disconnecting portions of Uzbekistan as well.

¶21. (C) Although Uzbekistan can easily disconnect from the CAPG, its domestic system still faces frequent deficits. The larger issue, however, is water, the Achilles Heel of Central Asia. An Uzbek withdrawal from the grid, absent an agreement with Tajikistan on direct power purchases, could force Tajikistan to increase winter water releases to its hydro plants. The rivers that feed Tajik hydro plants account for as much as a third of the flow into the Amu Darya; using more water in the winter could make for a very dry planting season in the spring in Uzbekistan. Many in Uzbekistan are aware of this risk and are wondering if this is a case where politics will trump prudence. It would not be the first time this happened in the region, though the usual pattern is to find a last-minute way to avert crisis.

¶22. (U) DAS Krol has not had an opportunity to clear this cable.
NORLAND